

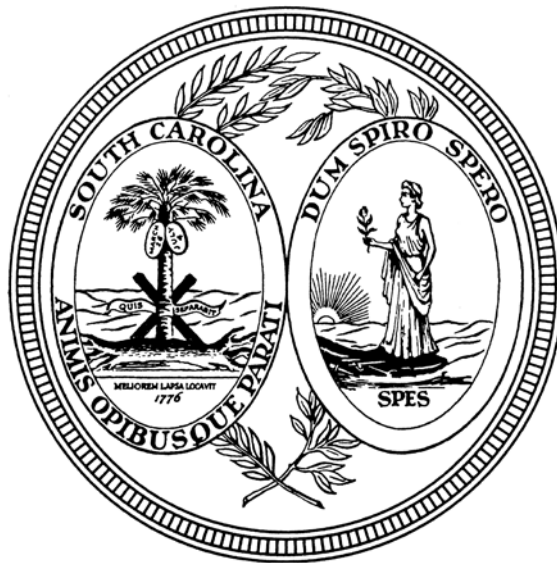


SOUTH CAROLINA GENERAL ASSEMBLY

Legislative Audit Council

February 2010

AN AUDIT OF THE SOUTH CAROLINA EDUCATION LOTTERY



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Legislative Audit Council

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Introduction

Audit Objectives

Sections 59-150-30(B) and 2-15-63(A) of the South Carolina Code of Laws require the Legislative Audit Council to conduct a management audit of the South Carolina Education Lottery (SCEL) every three years. We developed the following audit objectives after conducting preliminary audit work at the lottery.

- Review the lottery's procedures for purchasing the services of contractors to assist in operating scratch-off games and random number selection games.
- Evaluate the lottery's system for deterring the loss and theft of scratch-off tickets.
- Determine the extent to which the lottery has sales-based incentives for its employees.
- Review the information collected by the lottery in demographic studies of its players.
- Evaluate the lottery's efforts to deter the sale of lottery tickets to underage players.

We also determined the implementation status of the recommendations in our December 2005 audit.

Scope and Methodology

This audit focused on the operations of the South Carolina Education Lottery relevant to our audit objectives. The period we reviewed was generally 2006 through 2009.

We interviewed officials from agencies including SCEL, the State Budget and Control Board, the South Carolina Department of Alcohol and Other Drug Abuse Services, and lotteries in other states. We reviewed SCEL documents including lottery tickets, internal policies and procedures, statistical information on lottery players, security incident reports, and procurement records.

When addressing some of our objectives, we relied on computer-generated data maintained by SCEL. We performed tests to confirm the reliability of the data when significant to our objectives.

We conducted this performance audit in accordance with generally accepted government audit standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions, based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions, based on our audit objectives.

Background

The South Carolina Education Lottery was created in FY 01-02. Lottery ticket sales began in January 2002. As provided by state law, proceeds from sales must be used to support improvements and enhancements for educational purposes and programs.

The SCEL is governed by a nine-member commission with three members each appointed by the Governor, the President Pro-Tempore of the Senate, and the Speaker of the House of Representatives. The term of office for each commissioner is three years.

The lottery receives no appropriations from the General Assembly. Rather, funding for lottery operations is generated through the sale of lottery tickets.

As of June 2008, the lottery had 153 employees and approximately 3,600 retailers selling tickets. The SCEL headquarter office is located in Columbia. In addition, there are three regional claim offices/redemption centers in Columbia, Greenville, and Mount Pleasant.

Tables 1.1 and 1.2 show lottery revenues and expenditures in FY 08-09. Table 1.3 shows \$261.5 million in revenues transferred to support education.

Table 1.1: FY 08-09 Lottery Revenues

REVENUES	AMOUNT	PERCENT
Instant Games	\$642,042,661	64.45%
Powerball	118,164,741	11.72%
Online Games	236,899,282	23.49%
Fees and Other Revenue	3,374,811	0.33%
Non-Operating Income	144,300	0.01%
TOTAL	\$1,008,625,795	100.00%

Source: S.C. Education Lottery

Table 1.2: FY 08-09 Lottery Expenditures

EXPENDITURES	AMOUNT
Retailer Commissions and Incentives	\$71,255,655
Prizes	633,196,406
Instant and On-line Direct Costs	19,241,071
Operating Expenses	23,721,596
TOTAL	\$747,414,728

Source: S.C. Education Lottery

Table 1.3: FY 08–09 Change in Net Assets

ASSETS	AMOUNT
Starting Net Assets	\$1,664,142
Total Revenues	1,008,625,795
Total Expenses	(747,414,728)
Transfer to Education Lottery Account	(261,524,395)
Ending Net Assets	\$1,350,814

Source: S.C. Education Lottery

New Issues Regarding Lottery Operations

In this chapter, we address issues regarding lottery operations that we did not address in prior audits. We found the following:

- In some instances, the lottery's procurement records did not clearly state the reasons for awarding state contracts to companies that assist in developing and operating scratch-off games and number selection games.
- Without an authorized contract change order, the lottery paid approximately \$398,000 for a security barcode system on 241 million scratch-off tickets. Also without an authorized change order, the lottery paid \$408,000 for the rights to sell scratch-off tickets named for a television game show. The lottery reports that its new executive director, hired in July 2009, has implemented measures to improve the management of its contracts.
- The lottery has developed a system for deterring the loss and theft of scratch-off tickets.
- Based on an annual survey of South Carolinians, the lottery reports demographic data on its players and their expenditures. However, the lottery does not report per capita expenditures by demographic group.
- The lottery has implemented several initiatives to deter the sale of lottery tickets to minors, but it is not currently conducting compliance checks of lottery ticket retailers. Following our 2005 audit, the State Law Enforcement Division (SLED) assisted the lottery by conducting some compliance checks of retailers. However, SLED did not report the number of checks, the identification of the retailers involved, or the results of the checks for each retailer.
- The lottery awards pay incentives to its marketing and sales staff based on a "sales incentive plan."

Documentation of the Reasons for Awarding Lottery Vendor Contracts

We reviewed the procurement of vendors that assist the lottery in developing and operating its scratch-off and number selection games. We found that some of the lottery's records did not clearly state the reasons for assigning points to the various companies that submitted contract proposals. These points were used to determine which companies were awarded contracts.

The procurements were conducted jointly by SCEL and the Materials Management Office (MMO) of the State Budget and Control Board. The Budget and Control Board is a central administrative agency for South Carolina state government.

Criteria for Procurement Award

SCEL and MMO used a request for proposal (RFP) purchasing method to award lottery vendor contracts. The RFP method of purchasing allows a state agency to award contracts based on price as well as evaluation criteria other than price in order to select contracts “most advantageous” to the state.

S.C. Code §11-35-1530(9) states that when using the RFP method, “[t]he contract file must contain the basis on which the award is made and must be sufficient to satisfy external audit.”

In April 2006, the SCEL issued an RFP to “Provide [Scratch-Off] Tickets, Marketing Support Services, Warehousing and Distribution.” In June 2007, the SCEL issued an RFP to provide services related to number selection games such as Powerball and Palmetto Cash 5.

The evaluation of the scratch-off game proposals was based on the following criteria:

- 50% Cost
- 25% Offeror’s Understanding and Approach
- 15% Offeror’s Experience and Capability
- 10% Offeror’s Financial Qualifications

The SCEL selected evaluation panels consisting of current and former SCEL employees to evaluate the non-cost components of the proposals. The cost proposals were scored by outside experts.

The evaluation of the number selection game proposals was based on the following criteria:

- 35% Cost
- 35% Proposed Solution
- 20% Conversion and Business Continuity
- 10% System Architecture and Capacity Plan

The “proposed solution” criterion refers to the offeror’s proposal to create a lottery system that ensures long-term viability. The “conversion and business continuity” criterion refers to the offeror’s proposal to implement a new lottery system while minimizing revenue loss and retailer inconvenience. The criterion for the “system architecture and capacity plan” refers to various computer-related issues involved in the new gaming system.

Evaluator Scoring

During our review of the procurement records, we reviewed the numerical score sheets of each evaluator.

Scratch-Off Game Contract Proposals

The score sheets for the scratch-off game contract proposals contained no written explanations from the reviewers regarding the reasons they awarded the points they did. We were unable to determine why one vendor's proposal was scored higher or lower than that of another for this contract. It is important to note that subsequent to this RFP, in October 2006, MMO issued a directive requiring that the basis of each award be documented in the procurement file. MMO currently requires evaluators to complete a form with a brief written explanation of the reasons for their scoring decision.

Number Selection Game Contract Proposals

The score sheets for the number selection game contract proposals provided space for evaluators to give written explanations for their scores. However, we found that some explanations for the scores were not clear. For example:

- In explaining the score given to one vendor for “conversion and business continuity,” an evaluator wrote, “Aggressive conversion schedule, South Carolina Education Lottery staff steering committee, limited information on database migration, phased migration vs. big bang approach to conversion.”
- In explaining the score given to a vendor for “system architecture and capacity plan,” another evaluator wrote, “Achieved cmml for software level 4. Triple satellite retailer mapping.”

In contrast, we found other scoring explanations that were clear and unambiguous. For example:

- In explaining the score given to a vendor for “conversion and business continuity,” an evaluator wrote, “Very good business continuity plan. Past experience in conversions a plus. Data center location for SC already identified and secured. Will work alongside SCEL personnel to observe abilities, tools used, and business practices.”
- In explaining the score given to a vendor for “proposed solution,” another evaluator wrote, “The proposal’s strengths include: a willingness to customize the gaming application and having parameterized online game definitions. The program’s weaknesses include: having a highly customized gaming application that is difficult to support, providing a

poor level of detail of the gaming application and a limited corporate development organization.”

Recommendation

1. The Materials Management Office of the Budget and Control Board and the South Carolina Education Lottery should ensure that evaluators provide clear, unambiguous explanations of their scoring of future lottery contract proposals to comply with S.C. Code §11-35-1530(9).
-

Payments to Lottery Vendors

We reviewed payments made to two private companies for assisting the lottery in developing and operating scratch-off and number selection games. The lottery paid one company approximately \$806,000 for extra services without a contract change order authorized by the Budget and Control Board, as required by state law and regulation.

The lottery reports that its new executive director, hired in July 2009, has implemented controls to improve the management of its contracts. The executive director has added oversight of scratch-off games to the duties of the contract compliance officer for number selection games and has appointed a product development team.

State Law and Regulation

Under §11-35-1210(1) of the South Carolina Code of Laws and S.C. Regulation 19-445.2020.A.(1), the lottery is required to make purchases exceeding \$50,000 through the Budget and Control Board.

The Budget and Control Board manages changes to pre-existing contracts using a “change order” process. Section 11-35-310(4) defines a “change order” as:

... any written alteration in specifications, delivery point, rate of delivery, period of performance, price, quantity, or other provisions of any contract accomplished by mutual agreement of the parties to the contract.

S.C. Regulation 19-445.2015.A. states that:

Upon finding after award that a State employee has made an unauthorized award of a contract or that a contract award is otherwise in violation of law, the [Budget and Control Board] may ratify or affirm the contract or terminate it in accordance with this section.

Security Barcodes on Scratch-Off Tickets

From August 8, 2008, through October 15, 2009, the lottery paid one company approximately \$398,000 for a specific type of security barcode on approximately 241 million scratch-off tickets, for \$1.65 per thousand tickets. This purchase was conducted based on a verbal agreement between the lottery and the company, without a written contract change order or approval from the Budget and Control Board. During our review, the lottery and the company agreed to a contract change order which will save the lottery approximately \$720,000 over the remaining four years of the contract.

The Budget and Control Board awarded the current scratch-off ticket contract to the winning company in June 2006, following a “request for proposal” procurement process. The contract did not include a price for the barcode feature the lottery began purchasing in August 2008. The term of the contract is October 1, 2006, through September 30, 2013, with potential payments up to \$50 million.

In November 2008, the lottery contacted the Budget and Control Board regarding the purchase of the security barcode feature, which had begun three months earlier. In early November 2009, the lottery and the vendor agreed “in principal” to a contract change order that would require approval from the Budget and Control Board. Under this change order, the lottery would pay the vendor a lump sum of approximately \$597,000 to use the barcode feature from October 16, 2009, through the remainder of the contract. This amount is approximately 45% of the original price agreement, yielding total savings to the lottery of approximately \$720,000.

In January 2010, the Budget and Control Board ratified the payments of approximately \$398,000 already made by the lottery through October 15, 2009. After receiving this ratification, the lottery requested approval from the Budget and Control Board to pay \$597,000 for use of the barcode feature from October 16, 2009, through the end of the contract. On January 26, 2010, the Budget and Control Board indicated it would approve this change order, which would be finalized after it was signed by the vendor.

***The Price Is Right* Scratch-off Tickets**

In January 2009, the lottery paid \$408,000 to the same company for the rights to sell 2,040,000 five-dollar scratch-off tickets named for the television game show *The Price Is Right*. Lottery officials indicate that advertising and prizes were included by the vendor for this price. According to lottery officials, this payment was based on 4% of the retail price of each ticket ordered. The payment amount was included in a written agreement between the lottery and the company, but was not in the original contract and was not approved by the Budget and Control Board.

Recommendation

2. The South Carolina Education Lottery should comply with §11-35-1210(1) of the South Carolina Code of Laws and S.C. Regulation 19-445.2020.A.(1) when purchasing additional goods and services from companies with lottery contracts.

SCEL System for Deterring the Loss and Theft of Lottery Tickets

We examined the South Carolina Education Lottery's measures for deterring the loss and theft of scratch-off tickets. The SCEL Security Department monitors reports of missing packs of tickets. As authorized by state law, the SCEL has charged retailers for lost or stolen ticket packs and, on occasion, has revoked retailers' lottery licenses for failing to adequately secure their inventory.

State Law Regarding Missing Tickets

S.C. Code §59-150-220 outlines policies for retailers regarding the loss or theft of scratch-off tickets or ticket books.

- If tickets are lost or stolen before a pack is activated, and no tickets within the pack have been sold, the lottery retailer must be charged a nominal service fee.
- If tickets are lost or stolen after a pack has been activated or tickets within the pack have been sold, a lottery retailer must be charged the net sales value (retail sales value less commission) for each book.
- In the case of stolen tickets, the lottery retailer must provide the name of the investigating law enforcement agency and case number to the SCEL within 30 days. Once this information is provided, the amount the retailer must pay may be reduced by the low tier prize values of stolen tickets, pending payment at the time of the theft.
- The lottery may credit the retailer for tickets reported missing that are subsequently recovered and returned to the lottery.

S.C. Code §59-150-180(A) states that a lottery retailer's contract may be canceled, suspended, revoked, or terminated for reasons including, "failure to account accurately or timely for lottery game tickets, lottery games, revenues, or prizes..." or for "fraud, deceit, or misrepresentation." S.C.

Regulation 44-20.60 states that the SCEL executive director may suspend or revoke the license of a lottery retail outlet for failure to take adequate security precautions for the safe handling of tickets, lottery materials, or ticket sales proceeds. S.C. Code §59-150-150(B) states that any lottery applicant “must not be selected as a lottery retailer if [the applicant]...has been found to have violated the provisions of this chapter or a regulation, policy, or procedure of the commission, unless either *ten years have passed* since the violation or the board finds the violation both minor and unintentional in nature.” (Emphasis added.)

In addition to ticket revenue, lottery retailers may receive economic benefit from store traffic that lottery ticket sales create. Therefore, it is difficult to quantify the net financial loss that would result from having one’s lottery license revoked. The threat of losing one’s lottery license and being ineligible to re-apply for ten years may deter acts of fraud and ensure that retailers take adequate security precautions in managing lottery ticket packs.

We reviewed other states’ lotteries’ policies for lost or stolen tickets and found that South Carolina’s laws and regulations are similar to those in other states.

SCEL Security Department

The SCEL security department monitors reports of missing or stolen tickets. Lottery officials state that marketing sales representatives (MSRs), who travel to various retail locations, are responsible for examining security measures over inventory and reporting potential problems to the security department. SCEL officials report that, when a security issue arises, they send warning letters instructing the retailer to correct the problem before it becomes a significant issue.

Since January 2006, SCEL has revoked the licenses of eight retailer locations for “failure to secure inventory.”

Information Needed From Demographic Studies

Each year, SCEL contracts with a research firm to conduct a demographic survey of its players. Using the results of this survey, the lottery reports data on a wide variety of player attributes. However, the agency does not report per capita expenditures for the various demographic groups in South Carolina. As a result, it is difficult to assess the extent to which these groups play the lottery.

S.C. Code §59-150-325(C) required SCEL to provide the Lottery Oversight Committee with a demographic analysis of lottery players, conducted by an independent research firm, in each of the lottery's first five years of operation. The SCEL complied by issuing demographic reports from 2002 to 2006. An agency official reported that SCEL continues to produce the demographic study each year in order to provide the General Assembly with detailed information about lottery players and their levels of participation.

We reviewed a similar demographic study from the Texas lottery for comparison and found it reported median dollars spent per month per player, broken down by various demographic groups. Although the South Carolina study does not report this information, it is possible to calculate these statistics from the data that is already collected. An analysis of South Carolina lottery players' median per capita expenditures per month, broken down into demographic characteristics, would only require the SCEL to request that the research firm report it.

An agency official reported that the study is useful for an overview of lottery players but is not used to develop or market games. Requesting that this additional data be reported could provide SCEL with a more comprehensive picture of its customer base and a more accurate estimate of the extent to which different demographic groups play the lottery.

Recommendation

3. When reporting the results of demographic surveys of its lottery players, the South Carolina Education Lottery should include monthly per capita expenditures by demographic group.

Prevention of Sales to Minors

The South Carolina Education Lottery has implemented several initiatives to deter the illegal sale of lottery tickets to minors. However, during our review, we found that compliance checks of lottery retailers had not been conducted on a regular basis.

S.C. Code §59-150-210 (D) states, “Lottery game tickets or shares must not be sold to persons under eighteen years of age....” We reviewed SCEL activities for deterring the sale of lottery tickets to persons under 18. We found that the lottery has attempted to deter ticket sales to underage persons by placing notices on lottery play stations, in lottery retailer magazines, and on lottery tickets.

Following our 2005 audit, the State Law Enforcement Division (SLED) assisted the lottery by conducting some compliance checks of lottery ticket retailers. SLED, however, did not report the number of checks, the identification of the retailers involved, or the results of the checks for each retailer.

We found that other states conduct compliance checks to determine the extent to which retailers sell lottery tickets to underage persons. These checks involve sending an underage person to a lottery retailer to see if the retailer will sell a lottery ticket to a minor. A Massachusetts lottery official stated that lottery retailers significantly curtailed their sale of tickets to underage persons after the lottery started compliance checks.

The South Carolina Department of Alcohol and Other Drug Abuse Services (DAODAS) currently oversees compliance checks for the sale of tobacco products to underage persons. DAODAS publishes annual reports detailing the number of compliance checks performed, the number of sales to minors during the compliance checks, the age and gender of the youth inspectors, and other demographic and logistical information relating to the compliance checks. Additionally, DAODAS receives funding from the lottery to assist in the treatment of compulsive gambling disorder.

DAODAS could also conduct compliance checks on the sale of lottery tickets to underage persons.

Recommendation

4. The South Carolina Education Lottery should contract with the Department of Alcohol and Other Drug Abuse Services to conduct periodic checks of retailers’ compliance with S.C. Code §59-150-210 (D).

Sales-Based Pay Incentive Plans

The SCEL pays “sales incentives” to its marketing and sales staff. The lottery reports that these incentives totaled approximately \$184,000 in FY 08-09.

Under §59-150-80(A) of the South Carolina Code of Laws, the executive director of the lottery is not eligible for sales-based incentives. However, under this law, other lottery staff may receive incentives. In FY 08-09, individual staff received payments up to \$7,000 based on the achievement of the lottery’s organization-wide sales goals.

Lottery officials provided us with a lottery “sales incentive plan” for FY 08-09, which describes who may receive incentive payments and how they should be calculated.

Implementation Status of Recommendations in 2005 Audit

In our 2005 audit report, we made 23 recommendations regarding the lottery. In our 2009 audit, we reviewed the implementation status of each recommendation, as summarized below.

Salary Methodology for Lottery Employees

(1) The South Carolina Education Lottery should develop and implement a methodology for determining all employee salaries based on salaries in lotteries nationwide.

SCEL has implemented this recommendation.

In our 2005 audit, we reviewed the salaries of top-level lottery officials with job duties comparable to those in other state lotteries. We found that the salaries of South Carolina lottery executives were higher than many comparable officials in other states and recommended that SCEL develop and implement a methodology for determining all employee salaries based on salaries in lotteries nationwide.

SCEL contracted with an independent consultant to perform a comprehensive compensation study. The consultant analyzed SCEL's job positions using a custom survey that incorporated, among other data, information about other state lotteries.

The study concluded that SCEL's base salaries were on average 6% below the labor market median and 12% below market for total compensation.

Based on the survey data, the consultant made recommendations to the SCEL regarding the adoption of a pay philosophy, which SCEL has adopted. The executive director of SCEL also implemented a recommendation for the SCEL to: "Manage base salaries toward the Lottery's targeted level in the market (50th percentile)." Additionally, the executive director of SCEL implemented a recommendation regarding the adoption of salary grades and ranges.

Purchase of Promotional and Point-of-Sale Items

(2) The South Carolina Education Lottery should analyze the cost of purchasing promotional and point-of-sale items in-house as compared to the cost of purchasing these items through the advertising contractor. Based on the results of this analysis, if advantageous, adjustments to the advertising contract should be made.

SCEL has implemented this recommendation.

In 2005, we reviewed SCEL's use of contractors to purchase advertising and marketing services. We found that SCEL purchased promotional and point-of-sale items through its advertising contractor. The lottery had not documented that contracting out these responsibilities was more cost-effective than purchasing promotional and point-of-sale items in-house.

In 2007, SCEL entered into a new advertising contract to provide advertising services to supplement the agency's in-house marketing department. SCEL obtains services from its contractor on a cost-per-hour basis, making it cost-effective to procure promotional and point-of-sale items in-house to avoid the hourly fee when possible.

When SCEL re-bid its advertising contract, it brought many marketing and advertising functions in-house, including the purchase of promotional and point-of-sale items. Lottery records indicate that agency payments to the advertising contractor were \$45,000 less in FY 07-08 than in FY 06-07.

Procurement Card Policies and Procedures

(3) The South Carolina Education Lottery should formally incorporate the Budget and Control Board's policies and procedures for procurement cards, with any needed amendments, into its purchasing manual.

SCEL has implemented this recommendation.

In our 2005 audit, we found that, although lottery officials stated they used the procurement card policies and procedures suggested by the Budget and Control Board, they had not incorporated them into the lottery's purchasing manual. Lottery officials stated that they planned to do so.

In our follow-up, the SCEL provided us with a copy of the agency's Purchasing Card Program Policies and Procedures. After comparing this document with the Budget and Control Board's template for procurement card policies, we determined that the SCEL has formally incorporated the

Budget and Control Board's policies and procedures for procurements cards into its purchasing manual.

Procurement Card Training

(4) The South Carolina Education Lottery should implement formal training of employees with agency procurement cards regarding their usage and the relevant policies and procedures.

SCEL has implemented this recommendation.

In 2005, we reviewed SCEL's procurement card policy. We found that it was not clear whether the lottery conducted training for its cardholders, as required by the lottery's policies and procedures. Lottery officials did not provide us evidence that cardholders underwent training.

In our follow-up, SCEL provided us with evidence that it has implemented formal training of employees with agency procurement cards regarding their usage and the relevant policies and procedures. These documents included the date the orientation occurred and the name of the employee who received the training. Each training orientation documentation form included practices and procedures for procurement card usage.

Procurement Cardholder Agreements

(5) The South Carolina Education Lottery should ensure that employees with agency procurement cards sign "cardholder agreements."

SCEL has implemented this recommendation.

In our 2005 audit, we found that, prior to our review, three of the lottery's four cardholders had not signed "cardholder agreements," as required by the lottery's policies and procedures. In these agreements, employees are required to note that they understand the policies and procedures regarding procurement cards and the consequences of improper use.

In our follow-up, SCEL provided us with evidence that all employees who possess procurement cards have signed cardholder agreements.

Overall Communication of the Odds of Winning

(6) When the South Carolina Education Lottery advertises a top prize for any of its games, it should include the odds of winning a top prize.

SCEL has partially implemented this recommendation.

In our 2005 audit, we found that, when the lottery advertised its top prizes via television, radio, newspapers, and billboards, it did not include the odds of winning a top prize.

In our follow-up, we viewed and/or listened to television, radio, and billboard ads from February 2009. We found that:

- The lottery's advertisements on television and radio communicated top prizes and the odds of winning a top prize. The television ads included written but not verbal statements of the odds of winning (see below).
- The lottery's billboards communicated top prizes but not the odds of winning a top prize. In Virginia, lottery billboards communicate top prizes and the odds of winning a top prize.
- The lottery had no newspaper advertisements for its games during the period of our review.

Communication of the Odds of Winning in Radio and Television Ads

(7) When the South Carolina Education Lottery advertises a top prize for any of its games on television or radio, it should verbally communicate in the ad the odds of winning a top prize.

SCEL has partially implemented this recommendation.

In our 2005 audit, we found that neither the lottery's television nor radio ads included a verbal statement of the odds of winning a top prize.

In our follow-up, we viewed and listened to all six television ads and all four radio ads broadcast by the lottery in February 2009.

- Five of the television ads indicated a top prize, but none of the five included a verbal statement of the odds of winning. Four of the five included a written statement of the odds.
- All four radio ads indicated a top prize, of which three included a verbal statement of the odds of winning.

Communication of the Odds of Winning on Lottery Tickets

(8) When the South Carolina Education Lottery prints a top prize on a lottery ticket or number selection form, it should also print on the ticket or form the odds of winning the top prize.

SCEL has partially implemented this recommendation.

In our 2005 audit, we found that each of the lottery's scratch-off tickets indicated a top prize but did not communicate the odds of winning a top prize. We also reviewed the lottery's number selection games and found that the number selection form for one game indicated a top prize but did not communicate the odds of winning a top prize.

Based on a review of tickets sold in February 2009, we found that the lottery had partially implemented this recommendation.

- 52 of 53 scratch-off games sold by the lottery had tickets that indicated a top prize. None of the tickets for these 52 games communicated the odds of winning a top prize.
- Four of five lottery number selection games sold by the lottery indicated a top prize. The lottery printed the odds of winning a top prize on the number selection forms for each of the four games.

During our review, lottery officials noted they had begun to include the odds of winning a top prize on scratch-off tickets. As of September 2009, tickets for 23 of the lottery's 46 scratch-off games included the odds of winning a top prize. Lottery officials stated that, after ticket sales are completed for games contracted through March 16, 2009, all tickets citing a top prize will include the odds of winning a top prize.

Reaching Customers With Limited Reading Skills

(9) The South Carolina Education Lottery should obtain and follow advice from reading/literacy experts to ensure that written communications to lottery customers can be read by persons with moderate reading skills.

SCEL has partially implemented this recommendation.

In our 2005 audit, we found that the lottery had not consulted with reading/literacy experts to increase the likelihood that its written communications, including lottery tickets, can be understood by customers with limited reading skills.

During our follow-up, we found that in July 2009 the lottery consulted with literacy experts regarding printed marketing material used at its retail play stations. SCEL had not consulted with literacy experts regarding the language printed on its lottery tickets or number selection forms.

Retail Displays

(10) To ensure compliance with §59-150-60 (A)(18) of the South Carolina Code of Laws, the South Carolina Education Lottery should define in writing what constitutes the posting of “a conspicuous sign in a prominent location, inside the retailer’s premises and adjacent to the point of sale, clearly warning of the dangers and risks of gambling and the odds of winning and the odds of losing.”

SCEL has implemented this recommendation.

In our 2005 audit, we found that the lottery did not have a written definition to help retailers comply with the law that mandates a “conspicuous sign in a prominent location, ... adjacent to the point of sale.” The contract between the lottery and its retailers required these signs to be “at or near each cash register where tickets are sold.” This contractual phrase, however, was not more specific than the statutory phrase, “adjacent to the point of sale.”

In our follow-up, we found that the lottery’s retailer inspection sheet states that “instant tickets should be displayed in view of customers.” It also states that “mandatory [point-of-sale items] should be displayed on [the ticket] dispensers....” The mandatory point-of-sale items include a sign which communicates the dangers and risks of gambling as well as the odds of winning and losing.

Lottery Tickets Sold After All Top Prizes Have Been Claimed

(11) The South Carolina Education Lottery should discontinue the practice of selling lottery tickets when it knows that the top prizes printed on the tickets are no longer available.

SCEL has implemented this recommendation.

In our 2005 audit, we found that the lottery had continued to sell tickets for scratch-off games after all of the top prizes, printed on the front of the tickets, had been claimed. As a result, some customers may have purchased lottery tickets under the inaccurate impression that they had a chance of winning a top prize.

In our 2005 audit, we noted that the most effective method for ensuring that customers are not misled would be for the lottery to discontinue selling tickets when it knows that the top prizes printed on the tickets are no longer available.

In our follow-up, we reviewed SCEL's revised scratch-off game closing procedure, which went into effect on May 12, 2009. This new procedure states that, one business day after the last top prize in a game is claimed, to the extent practicable, the marketing department must notify the information technology, sales, and legal departments that ticket orders for the game must cease and that ticket activation must be disallowed. The procedure also requires that a message be sent to retailers ordering them to cease selling the game, to disable activation of the game's tickets, and to hold ticket inventory for the game in a secure place for return to the lottery.

Lottery Request to Amend End-of-Game Procedures

(12) The South Carolina Education Lottery should submit a request to the General Assembly to amend Regulation 44-40.10C.(2), so that lottery retailers are required to discontinue the sale of scratch-off lottery tickets immediately after being notified that a game has been officially ended.

SCEL has not implemented this recommendation.

In our 2005 audit, we found that the SCEL sells tickets when it knows that the top prizes printed on the tickets are no longer available. Lottery officials stated that there was legal authority for selling scratch-off tickets after the top prizes printed on the tickets are no longer available. In 2002, the General Assembly approved S.C. Regulation 44-40.10C.(2), which stated, "A lottery retailer may continue to sell tickets for each instant [scratch-off] game up to ninety (90) days after the official end of that game."

During our follow-up, a lottery official informed us that the SCEL had not submitted a request to the General Assembly to amend S.C. Regulation 44-40.10C.(2).

General Assembly Approval of End-of-Game Procedures

(13) The General Assembly should approve a request from the South Carolina Education Lottery to amend Regulation 44-40.10C.(2), so that lottery retailers are required to discontinue the sale of scratch-off lottery tickets immediately after being notified that a game has been officially ended.

The General Assembly has not implemented this recommendation, because the lottery has not submitted a request to amend S.C. Regulation 44-40.10C.(2).

In our 2005 audit, we found that Regulation 44-40.10C.(2) stated, “A lottery may continue to sell tickets for each instant [scratch-off] game up to ninety (90) days after the official end of that game.” This regulation was written by the lottery and submitted to the General Assembly for its approval.

During our follow-up, we found the lottery had not submitted a request to amend this regulation.

Election Day Sales

(14) The General Assembly should amend §59-150-210 (E) of the South Carolina Code of Laws to repeal the prohibition against lottery ticket sales on primary and general election days.

The General Assembly has not implemented this recommendation.

In our 2005 review, we noted South Carolina law requires that “a lottery ticket must not be sold on the date of any general or primary election.” We estimated that, in 2004, the election day prohibition cost the state about \$1.8 million in sales and \$600,000 in net proceeds.

Since the 2005 audit, the General Assembly has twice considered legislation to lift the election day ban on lottery ticket sales. Senate bill S. 121, introduced in the 2007-2008 legislative session, and Senate bill S. 110, introduced in the 2009-2010 legislative session, would allow lottery ticket sales on election days. Both bills passed the Senate, but not the House of Representatives.

SCEL officials confirmed that no lottery ticket sales occurred on two days in calendar year 2008 — the statewide primary election day (6/10/08) and the statewide general election day (11/4/08). We estimate that the prohibition of lottery ticket sales on these days resulted in a loss of \$3.7 million in sales and \$1.1 million in net proceeds.

No Data Collected on the Sale of Lottery Tickets to Minors

(15) The South Carolina Education Lottery should ensure that persons under the age of 18 are included in demographic studies initiated by the lottery that analyze the age of its customers.

SCEL has not implemented this recommendation, but it has worked with the State Law Enforcement Division to include lottery tickets in some undercover operations aimed at deterring retailers from selling alcoholic beverages to minors.

During its first five years of operation, SCEL was required to conduct a demographic analysis of players. In 2005, we found that, in the demographic surveys that were conducted, the lottery had not determined the extent of lottery ticket sales to customers under the age of 18.

Although SCEL has not implemented our recommendation, we have reconsidered this issue and have concluded that surveying minors about their illegal purchases of lottery tickets would not be an appropriate way of obtaining information. See page 13 of this report, for a discussion of the merits of conducting compliance checks of lottery retailers, in which undercover minors attempt to purchase lottery tickets.

Illegal Gambling at Retail Outlets

(16) The South Carolina Education Lottery should enact a written policy that requires its staff, during visits to lottery retail outlets, to observe the premises for evidence of potential illegal gambling.

(17) When the South Carolina Education Lottery observes evidence of potential illegal gambling, it should inform law enforcement officials, in writing.

SCEL has implemented these two recommendations.

In our 2005 audit, we found that while SCEL had taken steps to respond to illegal gambling at its retail outlets, there was no written policy addressing the need for SCEL to report instances of illegal gambling to the State Law Enforcement Division (SLED). We concluded that better enforcement of illegal gambling laws could yield additional revenue to the state.

In January 2006, the SCEL director of security sent a message to all agency employees, instructing them to notify the SCEL security department of any observed instances of illegal gambling. SCEL's response to our inquiry about the implementation status of this

recommendation states that, for all instances of suspected illegal gambling, the director of security sends an incident report to SLED. These incident reports include the incident type, information on the retailer, and facts regarding the incident. From January 2006 to April 2009, SCEL submitted 24 incident reports to SLED regarding observed instances of illegal gambling.

(18) The General Assembly should amend state law to authorize the South Carolina Education Lottery to deny, suspend, revoke, or terminate the contracts of lottery retailers or applicants who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction.

(19) The General Assembly should amend state law to authorize the South Carolina Education Lottery to impose administrative fines against lottery retailers who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction.

The General Assembly has not implemented these two recommendations.

In the 2005 LAC audit, SCEL officials reported that it was beyond their statutory authority to penalize a retailer for illegal gambling unless the retailer was convicted of a criminal offense, and that this prevented the SCEL from including illegal gambling in its contract as a justifiable reason to suspend, revoke, or terminate the contract with a retailer. We also found that state law did not give the lottery authority to issue administrative fines against retailers for illegal gambling.

S.C. Regulation 44-20.60(C)(2)(I) states that selling any lottery ticket, lottery chance or lottery product not approved by the lottery commission is prohibited and is grounds for the commission or the executive director to suspend or revoke a retailer's license. However, the related section of state law does not explicitly address illegal gambling as a reason for either revoking a license or levying a fine. S.C. Code §59-150-180 states that a lottery retailer's contract "may be canceled, suspended, revoked, or terminated by the commission" for reasons including "a violation of this chapter, a regulation, or a policy or procedure of this commission" or if the revocation of a retailer's license is "in the best interest of the lottery, the public welfare, or the State of South Carolina...."

There has been no proposed legislation to amend this section of the law since the 2005 audit.

Cell Phones

(20) The South Carolina Education Lottery should continue to reduce the number of cell phones provided to employees.

SCEL has not implemented this recommendation.

In our 2003 audit, we found that the lottery had 86 cell phones and approximately 130 employees. In 2005, we found that the lottery had 84 cell phones and approximately 150 employees. We questioned the lottery's justification for the number of cell phone assignments and calculated that reducing them by 30 would lower annual expenditures approximately \$24,000.

In our follow-up, we found that the lottery had 86 cell phones and approximately 140 employees. Lottery officials, however, report reducing the number of contracted minutes from 67,500 to 50,400 in May 2009 for an annual savings of over \$5,000.

Performance Measures

(21) The South Carolina Education Lottery should maintain data on the status of its performance measures.

SCEL has not implemented this recommendation.

In our 2005 audit of the lottery, we found that the agency had selected areas of operation in which to measure its performance but had not maintained up-to-date performance measure data.

In our follow-up, the lottery provided us with documents indicating a wide range of areas of operation in which to measure its performance. Examples of these areas included sales, internal operations, retailer licensing, and product development. These documents, however, did not contain up-to-date data. The most recent time period specified in the documents is FY 06-07.

Internal Audits

(22) The South Carolina Education Lottery should periodically conduct internal audits to review compliance with policies for prize payments.

SCEL has implemented this recommendation.

In our 2005 lottery audit, we found that the lottery had not conducted internal audits of compliance with its policies for prize payments.

In our follow-up, we found that the lottery had conducted periodic audits of prize payments processed by its claims centers in Charleston, Columbia, Fort Mill, and Greenville.

Appropriation of Lottery Funds

(23) The General Assembly should continue to consider whether previously appropriated lottery funds have been spent when deciding on future appropriations of lottery funds.

The General Assembly has implemented this recommendation.

In our 2005 audit, we found that the General Assembly, when appropriating lottery funds, had been considering the degree to which previously appropriated lottery funds had been spent.

In our follow-up, we found evidence that the General Assembly was continuing to consider whether previously appropriated lottery funds had been spent.

Agency Comments



January 26, 2010

Mr. Thomas J. Bardin, Jr., Director
South Carolina Legislative Audit Council
1331 Elmwood Avenue, Suite 315
Columbia, South Carolina 29201

Dear Mr. Bardin:

We very much appreciate the opportunity to work with you for the benefit of the State and look forward to your continued assistance. We also appreciate the professional and courteous manner in which the auditors conducted themselves under the capable leadership of Andy Young.

Following are the South Carolina Education Lottery's (SCEL) written responses to Legislative Audit Council (LAC) findings and recommendations.

Chapter 2, New Issues Regarding Lottery Operations

Documentation of the Reasons for Awarding Lottery Vendor Contracts:

We understand the intent of your recommendation to provide clear, unambiguous explanations of scoring in future lottery contract proposals to comply with the SC Budget and Control Board Material Management Office (MMO) October 6, 2006 directive. We will comply with the LAC recommendation but offer the following comments.

Instant (Scratch Off) Ticket Contract:

In its discussion, the LAC cites an MMO October 6, 2006 directive and related explanation form distributed by MMO to its procurement officers. As the LAC noted, the MMO directive was not in effect during the RFP process for the *scratch-off games* (instant ticket) contract with an official award date of July 7, 2006.

Being a sealed competitive proposal contract of a significantly material amount, SCEL evaluators in good faith exercised the due care they understood to be necessary to ensure compliance with the procurement code. We respectfully submit the score sheets for the scratch-off game contract proposals were completed based on procedures in place at the time, which did not require written explanation of the reasons for their scoring decision.

As with the online contract discussed below, the instant ticket contract was not protested by other bidders, a rarity in this industry.

Online System Contract (referred to by the LAC as the "random number selection game contract"):

We acknowledge the Material Management Office (MMO) October 6, 2006 directive was in effect during the evaluation process for "Statewide Lottery Computer System (System) including associated gaming products and support services" proposals. This directive and related explanation form were distributed by MMO to its procurement officers to ensure full compliance with S.C. Code §11-35-1530(9), which sets forth requirements for competitive sealed proposals and states in part, "The *contract file* must contain the basis on which the award is made and must be sufficient to satisfy external audit." [*Emphasis added*].

We believe the evaluators, with Information Technology Management Office (ITMO) guidance, fully complied with the law and their evaluation sheets satisfy external audit criteria.

We obtained the evaluation documents from ITMO for the online solicitation from 2007 and assert they are clear enough for each evaluator to refresh their memory and testify under oath as to the reason a particular point value was assigned to the respective evaluation criteria.

S.C. Code §11-35-2410 specifies that determinations required for competitive sealed proposals (RFPs) are final and conclusive "unless clearly erroneous, arbitrary, capricious or contrary to law." We believe the evaluator notes deemed to be unclear are relevant to the contents of the proposal being evaluated and provide a reasonable benchmark (both positive and negative) for the evaluation of the proposal.

Each evaluator was provided a minimum amount of space to provide "a brief explanation for each score given each evaluation criteria". The vendor proposals were several thousand pages long. While each proposal is evaluated on its own merits, scoring, to a degree, is an exercise in *relative merit* to determine the proposal "most advantageous" to the State. In our opinion, each of the evaluator's comments had meaning in relation to their scores and should not be compared among evaluators. The fact that one evaluator's reasons are more clearly stated than another evaluator does not mean the ones deemed to be less clear are "erroneous, arbitrary, capricious or contrary to law." SCEL also respectfully submits that the language quoted as "not clear" is not material to an evaluation of the contract file.

Being a sealed competitive proposal contract of a significantly material amount, SCEL evaluators in good faith exercised the due care they understood to be necessary to ensure compliance with the procurement code. In our opinion, the evaluation documents of the five evaluators, taken as a whole, comply with Section 11-35-2410, and the procurement file contains sufficient documentation to comply with the external audit provisions contained in Section 11-35-1530(9). After announcement of the contract award, all unsuccessful vendors requested the comments and score sheets of all evaluators under the Freedom of Information Act. We respectfully submit a complete *contract file* sufficient to satisfy external audit would likely have contained more documentation for the decision than just evaluator scoring forms, however, and most importantly, in this \$69,500,000 procurement, no protest was filed.

Payments to Lottery Vendors:

We fully understand the LAC's concerns regarding contract change orders, as SCEL shares the same concerns and regrets this occurred. Accordingly, we agree with the LAC recommendation and have already taken steps to implement it

As noted in the LAC report, as the new Executive Director, I acted quickly while still in interim status to ensure such errors do not occur again and SCEL fully complies with pertinent laws and regulations when purchasing additional goods and services from companies with lottery contracts.

I reassigned compliance review for the instant ticket contract to the online contract compliance officer, a person independent from the Marketing and Product Development Department. This action allows for better management of the online and instant ticket contracts as well as independent review of cost changes. We also established a team which includes the contract compliance officer, legal counsel, sales representatives and marketing representatives to ensure all parties are involved early in the process of game development. Such early and integrated involvement should ensure SCEL remains in compliance with pertinent laws and regulations when purchasing additional goods and services from companies with lottery contracts.

We respectfully provide the following explanations for the issues identified in the LAC report:

Fail Safe Bar Code:

Although the FailSafe bar code (described below) is addressed in SCEL's instant "scratch off" ticket contract, SCEL did not have the ability to use it until implementation of its new online system contract in

2008. The FailSafe bar code was important for two reasons: it provided additional security measures to prevent fraud by lottery retailers at their terminals and it was required in order to provide in-store "ticket checkers" which allow players to self-check their tickets without standing in line at the retailer.

In June 2006, the instant ("scratch off") ticket solicitation for the production of instant tickets and other services was awarded to Scientific Games International, Inc. (SGI). SGI is the owner of the patent which involves placement of a "Failsafe" security barcode (2D, PD417 or similar) under the latex portion of scratch-off tickets.

SCEL made a decision to incorporate the Failsafe barcode on instant tickets concurrent with the conversion of the central online computer system to Intralot on November 4, 2008 as doing so enhanced the security and integrity of SCEL's games.

The new online contract allowed for deployment of "ticket checkers" to allow customers to scan a ticket themselves, reducing the potential an unscrupulous retailer might wrongfully inform the person a ticket is not a winner or is a winner of a lesser amount. Unfortunately, this problem has been documented in Canada and several U.S. lotteries through independent and internal investigations as well as media reports over the past few years. The FailSafe barcode is becoming more widely used as one tool to thwart retailer fraud throughout North America. Virtually all of the FailSafe barcode area must be revealed before it can be read by the optical scanner which greatly reduces the chance for tampering by clerks or others. While ticket checkers are not the only means to educate the public and prevent retailer fraud, they are a key asset. There are other potentially beneficial aspects to utilizing the ticket checkers. Delays at the cash register caused by lottery players have often been cited as a negative aspect of the lottery. Ticket checkers help reduce the time required to serve the lottery customer and pay a claim. The ticket checkers also read online games such as Powerball, Pick 3, Pick 4, and Palmetto Cash 5.

Utilizing the FailSafe barcode was clearly within the scope of the instant ticket contract. The change order was necessary to quote a specific price as the RFP contained the following provision: 4.3.1(6) BAR CODES: "SCEL intends to utilize bar code scanning equipment and software. If any restrictions on the placement of the bar code apply, the Offeror shall state any such restrictions in the response. SCEL requires that any advance in technology in bar coding systems or methodology be similarly improved and advanced by the Offeror *at a price to be negotiated at a future date, but that the price for any improved bar code or other future pricing and identification system reflect the average pricing given to any other similarly situated lotteries.*" (Emphasis added)

The price SCEL agreed to pay for the Failsafe barcode was at all times well below the "price cap" provision of the RFP, before and after the proper authorization was obtained from MMO. The "initial price" agreed to in the "working papers" was, based upon information obtained by SCEL, 12.67% less than the average price SGI was charging other lotteries for this patented process. Working papers refer to a mutually agreed document describing all facets of each individual instant game: printing specifications, play style, prize structure, odds of winning, definitions of what constitutes a winning ticket, packaging instructions, shipping instructions and the various cost components used to determine a price per thousand for the quantity of tickets ordered (which varies by game). Other price concessions were also obtained from SGI regarding printing the FailSafe barcode on certain tickets. As noted by the LAC the final resolution of this matter resulted in a savings of approximately \$720,000 over the remaining term of the contract from the price initially agreed to by SCEL. Nevertheless, SCEL regrets that the appropriate Change Order authorization was not obtained in a timely manner.

As noted by the LAC, an internal miscommunication lead to the failure to obtain a Change Order before the agreed upon price was paid for the instant games printed in August of 2008. SCEL Legal staff, within a month of learning of this issue in October 2008, contacted MMO staff concerning the need to address this deficiency and to obtain the necessary approval. MMO worked with SCEL throughout 2009 to obtain the necessary documentation from SCEL and SGI supporting the requested change and to "ratify" the charges already incurred as required by the S.C. Consolidated Procurement Code.

As previously stated, to prevent such issues from occurring again, as the new Executive Director, I implemented organizational changes. We expanded the Online Contract Compliance Officer position to include the instant ticket printing contract formerly managed by SCEL Marketing and Product Development. This change will improve coordination between these contracts. Together, these contracts are responsible for the generation of virtually all of the revenue SCEL produces for education.

An SCEL attorney, although always involved as contractual issues arise, now participates at the very earliest stages of instant game product development. SCEL established a team at the end of July 2009 with representatives from several departments to oversee instant ticket development. In the future all actions relating to contract administration will be effectuated in writing and as specified in the procurement code and each respective solicitation.

Price is Right Licensed Game Scratch Off Tickets

While SCEL regrets not obtaining an authorized change order for this transaction, it is important to note that under the period of LAC review, from April 2006 to June 2009, SCEL paid over \$2 million to SGI for instant ticket printing and game-related costs. In January 2009, the lottery paid \$408,000 for the rights to sell the licensed property game *The Price is Right*, purchasing 2,040,000 five-dollar instant tickets. This particular transaction provided additional advertising, promotional items, promotional events and funding for an additional promotional prize. As previously stated, measures now enacted will serve to prevent such issues from occurring.

SCEL System for Deterring Loss and Theft of Lottery Tickets:

We appreciate your discussion regarding SCEL's system for deterring the loss and theft of lottery tickets. We would also note that the Internal Audit Department performs work each year to detect fraud through analysis of lottery tickets reported missing or stolen and winning ticket claims collected by lottery retailers. In addition to revoking licenses of retailers, SCEL has also received restitution and sought assistance from SLED in some instances.

Information Needed from Demographic Studies:

We agree with the spirit of this recommendation as we continuously strive to improve reporting of results. Section 59-150-60 (A), requires SCEL to "ensure that advertising content and practices do not target with the intent to exploit specific ethnic groups or economic classes of people." We will consider requesting the inclusion of monthly per capita expenditures by demographic group so long as we believe it will not appear SCEL is gathering this information to target certain ethnic groups or economic classes of people.

Prevention of Sales to Minors:

We agree with the intent of this recommendation and will pursue associating with DAODAS to conduct periodic checks of retailers' compliance with S.C. Code §59-150-210(D). SCEL coordinates with DAODAS regarding its gambling hotline and looks forward to establishing additional ties where possible.

To satisfy the intent of the prior LAC recommendation, we requested that the State Law Enforcement Division (SLED) incorporate attempts to purchase lottery tickets into their undercover operations for alcoholic beverage licensees. SLED did include the purchase of lottery tickets on a random basis for the buy attempts and provided a letter to acknowledge such.

According to information provided by SLED officials, agents conducted 5,276 undercover operations using underage persons attempting to buy alcoholic beverages in FY 2007-2008 with 613 violations charged. During those undercover operations, agents made periodic attempts on a random basis to purchase lottery tickets. According to SLED officials, no violations were detected. SLED officials also reported that SLED received 486 complaints during FY 2008 concerning violations of alcohol regulations. None were received reporting the sale of lottery tickets to underage persons.

Sales-Based Pay Incentive Plans:

Using a competitive process through the State Procurement Code, SCEL contracted independent consultant Milliman Consultants and Actuaries to perform an independent comprehensive compensation study. This study compared SCEL with other lotteries, as well as with regional public- and private-sector employers and published compensation surveys. Milliman presented its results to the SCEL Board in May 2007.

Among other recommendations, Milliman stated: "Based on our understanding of the Lottery's goals and objectives, as well as the wide-spread prevalence of incentives in the market, SCEL should adopt an incentive plan. We believe the incentive plan will provide higher levels of performance while "paying for itself."

SCEL management did not ask the Board to approve this recommendation even though such plans are used in the lottery industry. Management believed its current merit pay program to be adequate and opted not to include executive employees.

Traditional compensation factors in the lottery industry include incentive pay, pay for performance, bonuses, and other forms of compensation not generally associated with state agencies. SCEL pays certain sales employees incentive pay predicated on reaching certain defined goals.

Only four employees are eligible to earn an incentive of up to \$7,000. Retail Telephone Sales staff can earn up to \$2,500. The majority of eligible employees, our Marketing Sales Representatives in the field, can only earn up to \$3,600. SCEL paid \$184,000 in FY 08-09 to invaluable **non-executive** employees who assisted SCEL in earning over \$1 billion in sales.

CHAPTER 3. IMPLEMENTATION STATUS OF RECOMMENDATIONS IN 2005 AUDIT

Salary Methodology for Lottery Employees

As stated in the LAC report, SCEL contracted with an independent consultant to perform a comprehensive compensation study. The most recent study concluded that SCEL's base salaries were on average 6% below the labor market median and 12% below market for total compensation. The study also confirmed our assertion that SCEL had always operated under a valid method of compensating SCEL employees and determining appropriate salary ranges, which considered actual salaries in other state lotteries.

Purchase of Promotional and Point-of-Sale Items

We agreed with the LAC's prior recommendation regarding purchasing promotional and point-of-sale items in-house.

In FY 05, only 13 of the 309 (3%) advertising contractor invoices were for promotional items. As the LAC reported, all purchases were in accordance with the contract. SCEL did not believe it necessary to document it was more cost-effective for SCEL to perform the duties because they were covered by the ad agency retainer fee at the time. Considering the required monthly retainer, we attempted to delegate as many tasks as allowed to maximize services until such time as the contract was re-bid or renegotiated.

In accordance with our strategic plan, SCEL brought additional marketing and advertising functions in-house at the end of the advertising contract. These functions included purchase of promotional and point-of-sale items.

Procurement Card Issues

We strive to have policies and procedures in place to ensure prevention and detection of errors and irregularities. Formal policies along with procedural requirements such as training and cardholder

signatures are part of preventative measures to potentially deter individuals from knowingly or unknowingly circumventing policy. Additionally, detective measures such as internal audits are necessary. In our recent internal audit of procurement card purchases, all departments and card users were found to have used the card appropriately. In addition, Budget and Control Board policies on procurement card purchases were in place and were followed.

Although no amount of training will ever prevent circumvention of policy by an individual intent on doing so, we agree training and proper paperwork is essential. We will continue to provide and document training of purchasing card holders and will ensure employees sign cardholder agreements.

Overall Communication of the Odds of Winning:

SCEL understands the importance of effectively communicating game odds, and will continue to review all methods to communicate top prize odds to players, including all print, television and radio media as well as billboards.

The only billboards SCEL maintains are PowerBall® jackpot billboards updated via satellite. Language clarifying that the jackpot is an "Estimated Annuitized Jackpot" is included. SCEL prepared a billboard mock-up with top prize odds and determined it unreadable from a moving vehicle.

To communicate the PowerBall® odds of winning, SCEL places a double-sided sign in retail outlet windows which clearly state the odds of winning a top prize in a well-readable format, along with numerous other means of communicating the odds including the internet, in-store information, television and radio ads and the PID screens obtained with the new online contract. We believe these easily readable media to be the best means of providing the odds.

Communication of the Odds of Winning in Radio and Television Ads:

SCEL will reevaluate the possibility of adding verbal odds of winning information to more of its television ads. As noted, SCEL includes a written statement of the odds in television ads and will continue to include a verbal statement of the odds of winning a top prize in its radio ads.

Communication of the Odds of Winning on Lottery Tickets:

As noted in the report, SCEL currently prints the top prize odds, overall odds, and the odds of not winning in a bold and acceptable font size on all tickets for games contracted after March 16, 2009. There are currently only three older games remaining for sale to the public which do not contain this information on the ticket.

SCEL also includes Top Prize Odds on over-sized sample tickets we place at the point of purchase or on the retail play station for permanent review, as well as on a daily printed report at the retail location, and on the internet.

Reaching Customers with Limited Reading Skills:

SCEL always endeavors to provide a product that is easily interpreted by a broad range of the SC population. Compliance with legal requirements, particularly game rules, can affect readability. As noted, SCEL staff has sought advice from reading and literacy experts to determine whether modifications were warranted on certain documents. SCEL also has an extensive in-house review process to confirm readability. SCEL will continue to attempt to satisfy the spirit and intent of this recommendation.

Lottery Request to Amend End-of-Game Procedures:

Procedures have continued to change and evolve. Accordingly, SCEL will continue to evaluate necessary changes in regulation.

Election Day Sales:

SCEL has available and will gladly offer any research, data and/or other assistance requested at such time the General Assembly wishes to reconsider this issue.

No Data Collected on the Sale of Lottery Tickets to Minors:

As noted, SCEL attempted to satisfy the spirit and intent of the prior recommendation by requesting SLED include lottery purchases in their undercover operations of alcohol licensees with no violations detected. We discuss SLED efforts and agree to attempt to partner with DAODAS to collect data on the sale of lottery tickets to minors on page 4 herein.

Cell Phones:

SCEL continuously monitors cell phone cost and assignment and has lowered cell phone costs with each contract. SCEL has negotiated contracts lower than the State Contract amount for its cell phone vendors. SCEL also uses vendor-provided software to analyze usage, further define our business needs, and further reduce costs. SCEL exercises best practices by having written policies on cell phone use and requiring directors to justify each assigned cell phone annually. Finally, SCEL is a unique state enterprise entity which stands to lose profit when not operating in an emergency. SCEL has over 38 Marketing Sales Representatives in the field, as well as Information Technology, Security and Finance personnel conducting lottery business 24 hours a day 7 days a week. These positions constitute the majority of assigned cell phones. We sincerely believe the cost of being able to reach certain individuals on a dedicated line in an emergency does not exceed the benefit of ensuring lottery personnel are able to act immediately to ensure integrity and profitability 24/7 when millions of dollars could be at stake.

Performance Measures:

As with most activities, SCEL judiciously seeks to implement the best practice for measuring the performance of our organization toward attainment of our transfer goals and mission. We have worked on developing performance measures and a standard methodology for maintaining the data so that we can objectively determine if goals have been met. In the coming year we will be reviewing, evaluating and modifying our methodology for performance measures.

Thank you for this opportunity to comment. We sincerely appreciate the opportunity to work with you for the benefit of the State, and we look forward to your continued assistance.

Respectfully,



Paula Harper-Bethea
Executive Director

MARK SANFORD, CHAIRMAN
GOVERNOR

CONVERSE A. CHELLIS, III, CPA
STATE TREASURER

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January 26, 2010

Thomas J. Bardin, Jr.
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Re: An Audit of the South Carolina Education Lottery

Dear Mr. Barnett:

Thank you for the opportunity to respond to one recommendation mentioning the Materials Management Office of the Budget and Control Board in your report entitled *An Audit of the South Carolina Education Lottery*. In that recommendation, you wrote, "The Materials Management Office of the Budget and Control Board and the Education Lottery should ensure that evaluators provide clear, unambiguous explanations of their scoring of future lottery contract proposals to comply with S.C. Code section 11-35-1530(9)."

In the first procurement, you took exception with the evaluators' explanations of their scores, and then acknowledge that this procurement was conducted before this office implemented a process to require evaluators to explain their scores. Based upon a previous recommendation from your office, we instruct every evaluator, "For each proposal, evaluators will provide a brief written explanation for the points awarded for each evaluation criteria. This explanation will be included in the Procurement Officer's file and subject to public review under the Freedom of Information Act. In the event of a protest, each member of the evaluation panel may be called upon to support their reasoning before the Chief Procurement Officer, the Procurement Review Panel, or in a Court of Law." Yet, you have chosen to include the matter in your report in spite of the fact that the correction that you specified to our process has already been accomplished.

In the second procurement noted, you took exception with a single evaluator's notes as being insufficient, while applauding another evaluator's care in clarifying his scores. A single event of one evaluator's scoring comments hardly seems sufficient to warrant the inclusion of the Materials Management Office in your exception.

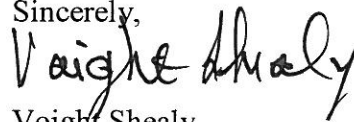
In the case of the Education Lottery procurements cited in your report, as in all others, our procurement managers oversee the evaluation process, which is performed by agency personnel. We instruct

evaluators in the scoring process and provide forms for them to explain their evaluation scores, but this evaluator simply did not comply with our instructions.

Regarding your recommendation, I am curious what course of action you recommend in that situation when an evaluator does not follow directions? Taking your recommendation to its logical conclusion, if an evaluator refused to comply with our instructions to explain his scores sufficiently, should we have rejected his evaluation and thrown out his or her scores?

Our procurement managers are trained to teach standards of independence, objectivity, and impartiality in the evaluation process. Evaluations are conducted in accordance with S.C. Code section 11-35-1530(7) and awards are made in accordance with S.C. Code section 11-35-1530(9). The system is designed in law to provide an objective selection process by having a panel of independently objective, qualified evaluators render their opinions as to the merits of proposals relative to predetermined criteria. Whether an evaluator has offered sufficient justification for a component of an evaluation places the procurement staff in the position of judging an individual evaluators knowledge and judgment. By including multiple skilled evaluators, the law, process, and procedures provide a balanced and objective procurement process. We will continue to endeavor to solicit sufficient explanations of evaluations from agency personnel, but we cannot guarantee that each evaluator will explain his scores to your satisfaction, as that evaluation, like the evaluation of the proposals themselves, is subjective.

Sincerely,

A handwritten signature in black ink that reads "Vaight Shealy". The signature is written in a cursive, flowing style.

Voight Shealy

Materials Management Officer

C: Frank Fusco
Eddie Gunn
Delbert Singleton, Jr.
Michael Sponhour
Materials Management Office Staff

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